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SIPDIS

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NEA FOR FRONT OFFICE; NEA/IPA FOR
GOLDBERGER/SHAMPAINE/BELGRADE; EEB FOR DIBBLE; NSC FOR
ABRAMS/WATERS; TREASURY FOR HARRIS/LOEFFLER/NUGENT/HIRSON;
BRUSSELS FOR LERNER; PARIS FOR JORDAN/DWYER

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SUBJECT: IMF OUTLINES PA'S FISCAL GAP AHEAD OF PARIS
DONORS' CONFERENCE

¶1. (SBU) Summary. The IMF reports that the Palestinian Authority (PA) will need international assistance totaling more than \$5.8 billion over the next three years to pay salaries, meet recurrent operational expenditures and make basic investments in health, education, security and infrastructure. The IMF team produced an overall fiscal framework for the PA based on an expectation of relaxed restrictions on access and movement for the Palestinian private sector and economic growth that slightly outpaces population growth. The projection assumes the situation in Gaza to remain unchanged and for the PA to undertake significant, but modest, reforms in addressing the civil service wage bill and utility subsidies. End Summary.

PA Needs More than \$1.8 Billion in 2008

¶2. (SBU) An IMF Mission, after two weeks in Ramallah and Jerusalem helping the Palestinian Authority (PA) prepare its fiscal and macroeconomic framework for the Paris Donors' Conference, debriefed the donor community on Thursday, November 15. According to estimates developed in consultation with the PA Ministries of Finance and Planning, the PA will need \$1.85 billion in external budget support in 2008, \$1.95 billion in 2009, and \$1.99 billion in 2010. The majority of this external assistance will be needed as budget support to meet recurrent expenditures (mostly the wage bill). The percentage of external assistance devoted to recurrent expenditures is expected to decline slightly over the three year period, as the PA freezes its wage bill and devotes more of its budget to capital expenditures. At these levels of external budget support, the IMF expects the PA to pay off approximately 60% of its \$900 million in accumulated arrears.

"Reasonable" Access and Movement Required,
While PA Holds the Line on Salaries

¶3. (SBU) Mission Director Oussama Kanaan said that the team based its economic projections on a baseline scenario that assumed "reasonable" improvements in access and movement for the Palestinian private sector and "modest growth" in the economy over the medium term (3.5% in 2008, 5% in 2009 and 6% in 2010), slightly outpacing population growth. The scenario also envisions increasing donor support through the Palestinian Ministry of Finance (MoF) and "more aggressive"

funding of public sector investment. Kanaan said, however, that IMF projections expected the maintenance of the status quo in Gaza.

14. (SBU) The IMF figures expect the PA, as part of its reform efforts, to essentially freeze the number and wages of public sector employees (with only an increase of 3,000 employees a year anticipated to meet increasing demands on the health and education sectors). In addition, the government will work with municipalities in the West Bank to address the problem of increasingly expensive utility subsidies. However, according to the reform plan laid out by the IMF, by 2010 the wage bill will still equal more than 20% of GDP and utility subsidies will total more than \$550 million annually.

15. (SBU) Overall, Kanaan said, the PA's three-year reform and development program "will not be viable" if restrictions on access and movement in the West Bank are not relaxed and the donor community does not meet the needs of the PA's recurrent budget and public investment costs. He thought the PA's development and investment projections (averaging approximately \$500 million/year) were reasonable, though the IMF did not have as much clarity in the area of security sector reform as they did in other sectors.

16. (SBU) The IMF team said that it had considered two other scenarios in addition to the "baseline" described above. In their "optimistic scenario", rapid improvements in movement and access allow the private sector to drive economic growth and unemployment declines to 15% by 2010. This improving economic situation is buttressed by substantial, flexible and timely donor support. In their "pessimistic scenario", restrictions on access and movement are not relaxed and donors do not provide adequate or timely support to the PA budget. As a result, the PA increasingly accumulates

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arrears, per capita GDP declines and the official unemployment increases to 28% by 2010, "with the real unemployment rate much higher." When donor representatives asked the IMF team to detail further the ramifications of this latter scenario, the IMF responded that they did not spend much time on it, "because the political and security consequences are so significant."

17. (U) The full IMF tables are available on ConGen Jerusalem's unclassified intelink site at:
http://www.intelink.gov/communities/state/pal_econ
WALLES